



6351-01-P

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 170

RIN 3038-AE09

Membership in a Registered Futures Association

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: The Commodity Futures Trading Commission (“Commission” or “CFTC”) is adopting a new rule (“Final Rule”) to require that all persons registered with the Commission as introducing brokers (“IB”), commodity pool operators (“CPO”), or commodity trading advisors (“CTA”), subject to an exception for those persons who are exempt from registration as a CTA pursuant to a particular provision of the Commission’s regulations, must, in each case, become and remain a member of at least one registered futures association (“RFA”).

DATES: The Final Rule will become effective [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. All persons subject to the Final Rule must comply with the Final Rule by not later than December 31, 2015.

FOR FURTHER INFORMATION CONTACT: Katherine Driscoll, Associate Chief Counsel, 202-418-5544, kdriscoll@cftc.gov; or Jacob Chachkin, Special Counsel, 202-418-5496, jchachkin@cftc.gov, Division of Swap Dealer and Intermediary Oversight,

Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

I. Background

Part 170 of the Commission's regulations relates to RFAs. An RFA is an association of persons registered with the Commission as such pursuant to Section 17 of the Commodity Exchange Act ("CEA" or "Act").¹ Subject to Commission oversight, RFAs serve a vital self-regulatory role by functioning as frontline regulators of their members (which members also remain subject to Commission oversight).

An RFA cannot enforce its rules over Commission registrants who are not members of the RFA.² As such, the Commission promulgated regulations 170.15 and 170.16 to require each registered futures commission merchant ("FCM"), and each registered swap dealer ("SD") and major swap participant ("MSP"), respectively, to be an RFA member, subject to an exception for certain notice registered securities brokers or dealers.³ Because the National Futures Association ("NFA") was the only RFA under Section 17(a) of the CEA⁴ at the time § 170.15 and § 170.16, respectively, were

¹ 7 U.S.C. 21.

² Those Commission registrants that are not RFA members are nevertheless subject to the rules and regulations of the Commission. See 7 U.S.C 21(e), which specifies that any person registered under the CEA, who is not an RFA member, "in addition to the other requirements and obligations of [the CEA] and the regulations thereunder shall be subject to such other rules and regulations as the Commission may find necessary to protect the public interest and promote just and equitable principles of trade."

³ 17 CFR 170.15 and 170.16. See also Registration of Swap Dealers and Major Swap Participants, 77 FR 2613 (Jan. 19, 2012).

⁴ 7 U.S.C. 21(a). NFA remains the only RFA under Section 17(a) of the CEA and is also a self-regulatory organization ("SRO"). Per Commission regulation 1.3(ee), SROs are designated contract markets, swap execution facilities, and registered futures associations. 17 CFR 1.3(ee). Certain SROs maintain and update, among other things, a standardized audit program and coordinate audit and financial statement

promulgated, these registered FCMs, SDs, and MSPs were required to be NFA members and, thus, were subject to NFA's rules. The Commission did not promulgate regulations requiring other Commission registrants, including IBs,⁵ CPOs,⁶ and CTAs,⁷ to be

surveillance activities over certain types of firms that are members of more than one SRO. See 17 CFR 1.52.

⁵ IB is defined, subject to certain exclusions and additions, in CEA Section 1a(31) as any person (except an individual who elects to be and is registered as an associated person of a futures commission merchant) (i) who (I) is engaged in soliciting or in accepting orders for (aa) the purchase or sale of any commodity for future delivery, security futures product, or swap; (bb) any agreement, contract, or transaction described in Section 2(c)(2)(C)(i) or Section 2(c)(2)(D)(i); (cc) any commodity option authorized under Section 4c; or (dd) any leverage transaction authorized under Section 19; and (II) does not accept any money, securities, or property (or extend credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom; or (ii) who is registered with the Commission as an IB. 7 U.S.C. 1a(31).

IB is further defined, subject to certain exclusions and additions, in Commission regulation 1.3(mm) as (1) Any person who, for compensation or profit, whether direct or indirect: (i) Is engaged in soliciting or in accepting orders (other than in a clerical capacity) for the purchase or sale of any commodity for future delivery, security futures product, or swap; any agreement, contract or transaction described in Section 2(c)(2)(C)(i) or Section 2(c)(2)(D)(i) of the Act; any commodity option transaction authorized under Section 4c; or any leverage transaction authorized under Section 19; or who is registered with the Commission as an IB; and (ii) Does not accept any money, securities, or property (or extend credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom. 17 CFR 1.3(mm).

IBs are subject to registration with the Commission under CEA Section 4d(g) and Commission regulation 3.4(a). 7 U.S.C. 6d(g) and 17 CFR 3.4(a).

⁶ CPO is defined, subject to certain exclusions and additions, in CEA Section 1a(11) as any person (i) engaged in a business that is of the nature of a commodity pool, investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in commodity interests, including any (I) commodity for future delivery, security futures product, or swap; (II) agreement, contract, or transaction described in Section 2(c)(2)(C)(i) or Section 2(c)(2)(D)(i); (III) commodity option authorized under Section 4c; or (IV) leverage transaction authorized under Section 19; or (ii) who is registered with the Commission as a CPO. 7 U.S.C. 1a(11).

CPO is further defined, subject to certain exclusions and additions, in Commission regulation 1.3(cc) as any person engaged in a business which is of the nature of a commodity pool, investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in commodity interests, including any commodity for future delivery, security futures product, or swap; any agreement, contract or transaction described in Section 2(c)(2)(C)(i) or Section 2(c)(2)(D)(i) of the Act; any commodity option authorized under Section 4c of the Act; any leverage transaction authorized under Section 19 of the Act; or any person who is registered with the Commission as a CPO, but does not include such persons not within the intent of the definition as the Commission may specify by rule or regulation or by order. 17 CFR 1.3(cc).

CPOs are subject to registration with the Commission under CEA Section 4m and Commission regulation 3.4(a). 7 U.S.C. 6m and 17 CFR 3.4(a).

⁷ CTA is defined, subject to certain exclusions and additions, in CEA Section 1(a)(12) as any person who (i) for compensation or profit, engages in the business of advising others, either directly or through publications, writings, or electronic media, as to the value of or the advisability of trading in (I) any

members of an RFA. One of the NFA rules to which NFA members are subject, however, is NFA's Bylaw 1101. NFA Bylaw 1101 requires that, generally, no NFA member may "carry an account, accept an order or handle a transaction in commodity futures contracts" for, or on behalf of, any non-member of NFA that is required to be registered with the Commission as, among other things, an IB, CPO, or CTA.⁸

Accordingly, any IB, CPO, or CTA required to be registered with the Commission that desires to conduct business with respect to commodity futures contracts directly with an FCM that is an NFA member must also become an NFA member, and derivatively, must ensure that it only conducts such business with those IBs, CPOs, or CTAs that also are NFA members. Therefore, § 170.15, at the time it was promulgated, operated in conjunction with NFA Bylaw 1101 "to assure essentially complete NFA membership from the universe of commodity professionals: [FCMs, CPOs, CTAs, and IBs]."⁹

contract of sale of a commodity for future delivery, security futures product, or swap; (II) any agreement, contract, or transaction described in Section 2(c)(2)(C)(i) or Section 2(c)(2)(D)(i); (III) any commodity option authorized under Section 4c; or (IV) any leverage transaction authorized under Section 19; (ii) for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the activities referred to in clause (i); (iii) is registered with the Commission as a CTA; or (iv) the Commission, by rule or regulation, may include if the Commission determines that the rule or regulation will effectuate the purposes of the Act. 7 U.S.C. 1a(12).

CTA is further defined, subject to certain exclusions and additions, in Commission regulation 1.3(bb) as any person who, for compensation or profit, engages in the business of advising others, either directly or through publications, writings or electronic media, as to the value of or the advisability of trading in any contract of sale of a commodity for future delivery, security futures product, or swap; any agreement, contract or transaction described in Section 2(c)(2)(C)(i) or Section 2(c)(2)(D)(i) of the Act; any commodity option authorized under Section 4c of the Act; any leverage transaction authorized under Section 19 of the Act; any person registered with the Commission as a CTA; or any person, who, for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the foregoing. 17 CFR 1.3(bb).

CTAs are subject to registration with the Commission under CEA Section 4m and Commission regulation 3.4(a). 7 U.S.C. 6m and 17 CFR 3.4(a).

⁸ NFA Bylaw 1101 is available at:

<http://www.nfa.futures.org/nfamanual/NFAManual.aspx?RuleID=BYLAW%201101&Section=3>.

⁹ Futures Associations: Futures Commission Merchants: Mandatory Membership, 48 FR 26304, 26306 and n.22 (June 7, 1983).

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) amended the CEA to establish a comprehensive new regulatory framework for swaps and security-based swaps.¹⁰ The new regulatory framework provides that, among other things, persons that engage in regulated activity with respect to swaps will be required to register with the Commission as IBs, CPOs, or CTAs, as appropriate. Because of these definitional amendments, the intersection of § 170.15 and NFA Bylaw 1101 no longer assures NFA membership for IBs, CPOs, or CTAs that are required to register with the Commission because, as noted above, NFA Bylaw 1101 relates only to commodity futures contracts.¹¹

II. Proposed Rule

On November 8, 2013, the Commission proposed to amend part 170 by adding § 170.17, which would, if adopted, have required each IB, CPO, and CTA registered with the Commission to become and remain a member of at least one RFA (“Proposal”).¹²

In the Proposal, the Commission specifically solicited comments regarding, among other things, the impact of the Proposal on CTAs that are registered with the Commission despite being eligible to rely on the exemption from registration set forth in Commission regulation 4.14(a)(9) (“§ 4.14(a)(9) Exempted CTAs”).¹³ Regulation 4.14(a)(9) provides that a person is not required to register with the Commission as a

¹⁰ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

¹¹ For example, as noted in the Proposal, currently Commission-registered CTAs, CPOs, and IBs engaging solely in swap-related activities are not captured by the intersection of § 170.15 and NFA Bylaw 1101 and, thus, are not required to be NFA members. As such, these registrants, to the extent that they have not voluntarily become NFA members, are not being supervised in the same manner as Commission registrants engaging in similar activities relating to commodity futures contracts, which registrants are effectively required to be NFA members.

¹² See Membership in a Registered Futures Association, 78 FR 67078 (Nov. 8, 2013).

¹³ 78 FR 67080 (Nov. 8, 2013).

CTA if it does not: (i) direct any client accounts; or (ii) provide commodity trading advice based on, or tailored to, the commodity interest or cash market positions or other circumstances or characteristics of particular clients.¹⁴ When the Commission promulgated regulation 4.14(a)(9), it stated that “[a] CTA exempt under rule 4.14(a)(9) that wishes to apply for registration or retain its current registration may do so.”¹⁵ Therefore, CTAs that may avail themselves of the exemption from registration in regulation 4.14(a)(9) may be currently registered with the Commission and may so register in the future.

The comment period for the Proposal ended on January 7, 2014.¹⁶ The Commission received two substantive comments in response to the Proposal¹⁷ and, in consideration of those comments, is adopting the Proposal subject to certain changes, as noted below.

III. Summary of Comments

In response to the Proposal, the Commission received two substantive comments, one from NFA and one from James W. Lovely, Esq. (“Lovely”).¹⁸ Both comments related to the impact of the Proposal on CTAs. No comments were received in response to the CPO and IB aspects of the Proposal.

¹⁴ 17 CFR 4.14(a)(9). This exemption from CTA registration generally pertains to persons only providing advice to the general public, such as in a newsletter, and not to specific clients.

¹⁵ See Exemption from Registration as a Commodity Trading Advisor, 65 FR 12938, 12941 (March 10, 2000).

¹⁶ The Proposal inaccurately stated the comment period ended on January 17, 2014. To reflect the accurate date, the Federal Register published a correction that the comment period ended on January 7, 2014. See 78 FR 67985 (Nov. 13, 2013). Nonetheless, the Commission considered all comments received by January 17, 2014.

¹⁷ See <http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1424>.

¹⁸ NFA Comment Letter and James Lovely, Esq. Comment Letter.

A. NFA Comment

NFA supported the Proposal as an appropriate and effective way to require IBs, CPOs, and CTAs engaging in swaps activities that otherwise are not captured by the intersection of NFA Bylaw 1101 or NFA Compliance Rule 2-36¹⁹ to become and remain NFA members, and comply with the applicable NFA requirements. However, NFA recommended that the Commission exclude § 4.14(a)(9) Exempted CTAs from the Proposal. In support of its position, NFA stated that its existing rules focus primarily on an intermediary's conduct with respect to clients and thus have little applicability to CTAs that do not direct client accounts or otherwise exercise discretion (i.e., § 4.14(a)(9) Exempted CTAs).

B. Lovely Comment

Conversely, Lovely generally stated that the Proposal “while well-intentioned, is ill-founded in many respects” and argued that the costs associated with further requiring registered CTAs to become and remain RFA members would be disproportionate to any regulatory benefit.

Lovely discussed those CTAs that register with the Commission even though they may not be required to so register (e.g., because they may avail themselves of a registration exception or exclusion provided under Commission regulation 4.14(a) or Sections 1a(12)(B) or 4m(1) of the CEA, respectively). According to Lovely, these

¹⁹ Clause (d) of NFA Compliance Rule 2-36 applies to forex transactions and requires that no NFA member carry a forex account for, accept a forex order or account from, handle a forex transaction for or on behalf of, receive compensation (directly or indirectly) for forex transactions from, or pay compensation (directly or indirectly) for forex transactions to any non-member of NFA, or suspended member, that is required to be registered with the Commission as, among other things, an FCM, IB, CPO, or CTA in connection with its forex activities. NFA Compliance Rule 2-36 is available at: <http://www.nfa.futures.org/nfamanual/NFAManual.aspx?RuleID=RULE%202-36&Section=4>.

CTAs register for legal comfort in light of the “practical ambiguities around concepts [related to CTA registration requirements] such as ‘solely incidental’, ‘principal business or profession’, ‘holding out’ and ‘tailored advice’” but do not have to become NFA members, so long as such CTAs do not manage or exercise discretion over customer accounts or funds.²⁰ He argues that these CTAs’ voluntary registration benefits the CFTC and that such persons will likely deregister if the Commission adopts the Proposal.²¹

Lovely further stated that the CFTC “significantly underestimates the cost of NFA [membership]” for these CTAs who are not currently required to become NFA members. He noted that most of such CTAs “have only incidental involvement with commodity interests” and, if required to become NFA members, “would need to retain external legal counsel or compliance consultants to try to ascertain [which NFA rules] apply to their activities and, if so, how to comply with the same.” Notwithstanding that Lovely argues that many NFA rules are not applicable to such CTAs,²² he estimates that “external legal and compliance assistance ... could easily cost [such a CTA] \$15,000.00 to \$20,000.00 per year.”

IV. Final Rule

²⁰ Presumably Lovely means that such CTAs would not be captured by the intersection of § 170.15 and NFA Bylaw 1101.

²¹ In this regard, Lovely also asserted that if the Commission adopts the Proposal, the First Amendment rights of these CTAs could be jeopardized, and, in some cases, such CTAs may drop their CFTC registration entirely “in reliance on ... [their] commercial free speech rights under the U.S. Constitution.”

²² Lovely provided a non-exhaustive list of what he believes to be inapposite NFA member rules including rules regarding: (1) account opening, risk disclosure and trading authority; (2) bunched orders and order allocation; (3) suitability or churning security futures products; (4) CTA program and performance disclosure for managed accounts or pools; (5) solicitation and execution of customer orders; (6) disaster recovery protocols (other than in connection with CFTC mandated record retention); (7) trading programs, performance and related promotional materials; (8) anti-money laundering; and (9) quarterly reporting of assets under management, trading programs, performance, carrying brokers and the like.

The Commission, in consideration of the comments received by it on the Proposal, is adopting the Proposal but excluding § 4.14(a)(9) Exempted CTAs from the Final Rule.²³ The Final Rule will help ensure the integrity of the swaps and futures market and its participants by subjecting all registered IBs, CPOs, and CTAs, except for § 4.14(a)(9) Exempted CTAs, to NFA's developed set of rules and oversight capabilities.²⁴ As such, the Commission believes that the markets are better served, and the public better protected, by having persons subject to the requirements of the Final Rule become RFA members.²⁵

After considering the comments, the Commission is persuaded by Lovely and NFA that NFA's rules have little applicability to § 4.14(a)(9) Exempted CTAs and, thus, there would be little benefit from requiring § 4.14(a)(9) Exempted CTAs to become and remain RFA members.

The Commission, however, is not persuaded that other registered CTAs, regardless of whether such CTAs are required to register with the Commission, should be excluded from the requirements of the Final Rule. Any registered CTA that does not meet the requirements of § 4.14(a)(9) would, by definition, be engaged in either (i) directing client accounts, or (ii) providing commodity trading advice based on, or tailored

²³ Notwithstanding this exclusion, if a person is a § 4.14(a)(9) Exempted CTA and registered as an IB or CPO, then such person shall still be subject to the requirements of the Final Rule in its capacity as a registered IB or CPO, as the case may be.

²⁴ The Commission notes that, as a result of the Final Rule, any person not required to register, and not registered, with the CFTC would not subsequently become subject to any NFA-imposed requirement unless such person voluntarily elects to become so registered. Any adverse financial, commercial, or other impact, including the potential chilling effect on free speech, which could result from the Final Rule for such CTAs, could be avoided simply by relying on the proper regulatory exclusion or exemption without having to even incur the cost of filing a notice with the CFTC or NFA.

²⁵ This is consistent with the Commission's rationale for § 170.15; that there should be essentially complete NFA membership from the universe of commodity professionals. See supra at n.10.

to, the commodity interest or cash market positions or other circumstances or characteristics of particular clients. As noted above, and consistent with § 170.15, the Commission believes that RFA supervision of registered CTAs engaging in these activities is beneficial to the markets and the clients of such CTAs.

In addition, the Commission believes that Lovely's cost estimates are very high for retaining advisors in relation to NFA's rules. Assuming a CTA was to contact an attorney familiar with Commission regulations and NFA rules applicable to CTAs, the Commission believes that determining which NFA rules are applicable to such a CTA would be a routine task that would not take a substantial amount of time.²⁶

Furthermore, with respect to those CTAs that opt into CFTC registration to avoid making determinations as to their activities in relation to their eligibility for the exceptions or exclusions from the CTA registration requirements noted in Lovely's comments, such persons should review available guidance from the Commission and consult with their advisors and Commission staff, as necessary, to determine if registration is required.²⁷

In support of the Final Rule, Section 4p of the CEA authorizes the Commission to "specify by rules and regulations appropriate standards with respect to training,

²⁶ As noted above, Lovely himself refers to many of these rules as "inapposite." Such a description belies Lovely's argument that any substantial legal review would be required to determine whether NFA rules would apply to one of the CTAs about which Lovely comments.

Moreover, the Commission believes the costs of compliance review in subsequent years would be significantly less than the initial review costs, because it is likely that only the changes to NFA rules that took place during the prior year would need to be considered.

²⁷ The Commission notes that it is not of the view that making such a definitive determination is impossible or exceedingly difficult, as Lovely's comment suggests. However, the Commission does recognize that, once this determination has been made, and depending on the determination, a Commission registrant may need time to review and possibly reorganize its business in order to ensure its compliance with NFA's rules or undertake the deregistration process, as the case may be. Therefore, the Commission is providing the extended compliance period described in the **DATES** section above.

experience, and such other qualifications as the Commission finds necessary or desirable to insure the fitness of persons required to be registered with the Commission.”²⁸

The Final Rule also provides a means for assuring that the purpose of Section 17(m) of the CEA,²⁹ allowing for compulsory RFA membership, is achieved.³⁰ The Commission believes that the Final Rule is reasonably necessary and desirable to effectuate comprehensive and effective market oversight by NFA in its capacity as an SRO. As the only RFA, NFA serves as the frontline regulator of its members, subject to Commission oversight. Without such mandatory membership in NFA or another RFA, effective implementation of the programs required by Section 17 of the CEA and NFA’s self-regulatory programs could be impeded.³¹

In summary, by mandating RFA membership by each registered IB, CPO, and CTA, except § 4.14(a)(9) Exempted CTAs, the Final Rule enables the Commission to further ensure the fitness, and provide for direct NFA oversight, of these Commission registrants.

²⁸ 7 U.S.C. 6p. Also, Section 8a(5) of the CEA authorizes the Commission “to make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes” of the CEA.

²⁹ 7 U.S.C. 21(m).

³⁰ See Futures Associations: Futures Commission Merchants: Mandatory Membership, 48 FR 26304 (June 7, 1983).

³¹ The Commission notes that in addition to the authority discussed herein, as noted previously, CPOs and CTAs are subject to registration with the Commission under Section 4m of the CEA, and IBs are subject to such registration under Section 4d(g) of the CEA. 7 U.S.C. 6m and 6d(g).

V. Administrative Compliance

A. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (“PRA”)³² imposes certain requirements on Federal agencies, including the Commission, in connection with their conducting or sponsoring any collection of information, as defined by the PRA. An agency may not conduct or sponsor, and a registered entity is not required to respond to, a collection of information unless it displays a currently valid control number by the Office of Management and Budget (“OMB”).

In connection with the Proposal, the Commission anticipated that, if adopted, the Final Rule would simply require an amendment to the number of respondents included in OMB Collection 3038-0023.³³ The basis for this preliminary finding was that, at the time of the Proposal, NFA had indicated that certain CPOs, CTAs, and IBs were registered with the Commission, but not NFA members. Therefore, because registration and membership require the filing of Form 7-R, the Commission initially believed these respondents’ paperwork burden would have been affected by the Proposal.

As discussed above, the Final Rule does not require IBs, CPOs, or CTAs to register with the Commission. Rather, the Final Rule only requires that certain of such persons that register with the Commission become and remain an NFA member. To indicate NFA membership an applicant needs to “check a box” on Form 7-R.³⁴ Current OMB Collection 3038-0023 captures the burdens associated with the registration process

³² 44 U.S.C. 3501 et seq.

³³ See OMB Control No. 3038-0023, <http://www.reginfo.gov/public/do/PRAOMBHistory?ombControlNumber=3038-0023>.

³⁴ The Commission has designated NFA to receive Form 7-R submissions on its behalf. The Commission notes that application for NFA membership is incorporated in Form 7-R.

for these persons, including the filing of and updating of Form 7-R for registration purposes. Therefore, to comply with the Final Rule, such registrants that are not NFA members, would be required to “check-the-box” on Form 7-R indicating their status as an NFA member.

Accordingly, because the burden associated with updating Form 7-R is currently captured in OMB Collection 3038-0023, and those persons who are directly impacted by the Final Rule are either currently registered with the Commission (i.e., have already filed a Form 7-R) or will be required to file a Form 7-R in connection with their registration with the Commission, no adjustment is necessary to take into account the number of Commission registrants who will have to become NFA members as a result of the Final Rule. Further, the Commission believes the additional burden of “checking the box” on Form 7-R to be non-substantive. Therefore, upon further review and for the reasons stated above, the Final Rule does not require amending existing OMB Collection 3038-0023.³⁵

B. Regulatory Flexibility Act

The Regulatory Flexibility Act³⁶ requires federal agencies, in promulgating regulations, to consider the impact of those regulations on small entities. In the Proposal, the Commission certified that the Proposal would not have a significant economic impact on a substantial number of small entities.

³⁵ The Commission further believes that many Commission registrants’ recordkeeping obligations associated with preparing for an NFA audit are already covered by other OMB control numbers. For example, §§ 4.23 and 4.33 of the Commission’s regulations are recordkeeping requirements associated with registered CPOs and CTAs, respectively, which are covered by OMB control number 3038-0005.

³⁶ 5 U.S.C. 601 et seq.

1. CPOs

The Commission has previously determined that CPOs are not small entities for purposes of the Regulatory Flexibility Act.³⁷ Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the Final Rule will not have a significant economic impact on a substantial number of small entities with respect to CPOs.

2. IBs and CTAs

The Commission has previously determined to evaluate within the context of a particular rule proposal whether all or some IBs or CTAs should be considered to be small entities and, if so, to analyze the economic impact on them of any such rule.³⁸

Since there may be some small entities that are IBs or CTAs and would be required to become NFA members, the Commission has considered whether this rulemaking would have a significant economic impact on these entities.

The Final Rule requires all IBs and CTAs, except § 4.14(a)(9) Exempt CTAs, who register with the Commission to become RFA members. This would require such IBs and CTAs to pay membership dues, “check a box” on Form 7-R, and ensure that they are prepared for an NFA audit.³⁹ As noted in the Proposal, the Commission is of the view that any costs associated with preparing for an audit by the NFA should not be

³⁷ Policy Statement and Establishment of Definitions of “Small Entities” for Purposes of the Regulatory Flexibility Act, 47 FR 18618, 18619 (Apr. 30, 1982).

³⁸ See, with respect to CTAs, 47 FR at 18620 (Apr. 30, 1982); and see, with respect to IBs, Introducing Brokers and Associated Persons of Introducing Brokers, Commodity Trading Advisors and Commodity Pool Operators; Registration and Other Regulatory Requirements, 48 FR 35276 (Aug. 3, 1983).

³⁹ See 78 FR 67083 (Nov. 8, 2013). As stated in the booklet titled “NFA Regulatory Requirements: For FCMs, IBs, CPOs, and CTAs,” NFA audits have two major objectives: (1) to determine whether the firm is maintaining records in accordance with NFA rules and applicable CFTC regulations; and (2) to ensure that the firm is being operated in a professional manner and that customers are protected against unscrupulous activities and fraudulent or high-pressure sales practices.

substantially different from, or significantly exceed, the costs associated with preparing for an audit by the Commission, which every registered person would already be responsible to do.⁴⁰ Moreover, because the Final Rule only pertains to Commission Registrants, any audit related costs incident to NFA membership would be negligible, and should not have a significant economic impact on IBs or CTAs that may be small entities. The Commission also stated its preliminary belief that NFA membership would impose few additional compliance costs on affected entities, because these entities are already subject to the majority of regulations that NFA enforces, whether or not they are NFA members. The Commission specifically requested comment on any additional compliance costs beyond those an entity would face as a result of it being registered with the Commission.

a. Comments on Costs to CTAs

In response to the Proposal, a comment from Lovely stated that most CTAs that opt into CFTC registration and do not manage or exercise discretion over customer accounts or funds are “small or one-person operations or may have only incidental involvement with commodity interests.” Further, Lovely asserts that, although many of NFA’s rules are not relevant to such CTAs, the Commission understates the cost of required NFA membership, including that the costs to these CTAs of reviewing and complying with such rules would be approximately \$15,000 to \$20,000 annually.

As discussed above, the Commission believes that Lovely’s compliance cost estimates are very high. Rather, the Commission believes that the costs faced by a CTA

⁴⁰ As noted above, the Commission believes that many of the recordkeeping obligations associated with preparing for an NFA audit are already required for Commission registrants. Moreover, given the average periodicity for NFA audits, the magnitude of annual audit-related costs is limited.

would, at most, be approximately \$2,950 in the first year and \$1,476 in subsequent years.⁴¹ The Commission does not believe that these amounts plus the \$750 membership dues required of all NFA members that are CTAs, results in an unreasonable burden on any CTAs (including those that may be small entities under the Regulatory Flexibility Act).⁴² Further, as discussed above, § 4.14(a)(9) Exempted CTAs (i.e., those CTAs that neither manage nor exercise discretion over customer accounts or funds and that do provide clients advice described in § 4.14(a)(9)(ii)) will not be required to become or remain RFA members pursuant to the Final Rule and, thus, will not face any compliance costs from the Final Rule.

b. Commission Determination

Accordingly, for the reasons stated above, the Commission believes that the Final Rule will not have a significant economic impact on a substantial number of small entities. Therefore, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the Final Rule being published today by this Federal

⁴¹ This estimate is based on the following labor estimates for this determination: for the first year, 6 hours of an attorney; in subsequent years, 3 hours of an attorney, in each case at approximately \$492.21/hour. The estimate of the hourly cost is from the Securities Industry and Financial Markets Association's Report on Management and Professional Earnings in the Securities Industry - 2013, modified by CFTC staff to account for an 1800-hour work-year and multiplied by 5.35 to account for firm size, employee benefits, and overhead. The Commission believes that the use of this multiplier is appropriate here because the Commission is assuming that persons retain outside advisors to assist in complying with NFA rules. The Commission rounds to two significant digits.

⁴² Assuming that IBs would face similar compliance costs as CTAs, the Commission does not believe that these costs result in an unreasonable burden on any IBs (including those that may be small entities under the Regulatory Flexibility Act). Further, as of June 30, 2015, all registered IBs that are not members of NFA are pending withdrawal of their Commission registration. Accordingly, the Commission believes that no currently registered IBs will be impacted by this rule.

The Commission also notes that, pursuant to Section 17(d) of the Act, each CTA or IB that is registered with the Commission, but not an RFA member is required to "... pay to the Commission such reasonable fees and charges [established by the Commission] as may be necessary to defray the costs of additional regulatory duties required to be performed by the Commission because such person is not a member of an [RFA]." 7 U.S.C. 21(d). The Commission has not yet established any such fees or charges, but noted in the release for § 170.15 that these charges are likely to be greater than the costs attendant to RFA membership. See 48 FR at 26311.

Register release will not have a significant economic impact on a substantial number of small entities.

C. Considerations of Costs and Benefits

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing an order. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of the following five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors.

1. Background

As discussed above, the Dodd-Frank Act amended the CEA to establish a comprehensive new regulatory framework for swaps markets and, in doing so, required IBs, CPOs, and CTAs acting in relation to swaps to register with the Commission. These newly registered persons, however, are not currently required to become NFA members because, as discussed above, they are not captured by the intersection of § 170.15 and NFA Bylaw 1101.

NFA cannot enforce its rules over Commission registrants who do not become NFA members, including IBs, CPOs, and CTAs active solely in relation to swap transactions, which are not currently required to become NFA members. Thus, the Final Rule requires registered IBs, CPOs, and CTAs, except § 4.14(a)(9) Exempted CTAs, to become NFA members similarly to how § 170.15 presently requires FCMs to become

NFA members and how § 170.16 requires the same of SDs and MSPs. In conjunction with §§ 170.15 and 170.16, the Commission is intending to create an oversight regime that ensures more consistent treatment of its registered intermediaries. The Commission believes that the Final Rule is reasonably necessary to ensure the fitness and comprehensive regulation and appropriate oversight of such persons.

In assessing the costs and benefits of the Final Rule, the Commission employs a status quo baseline. The Commission analyzes the cost and benefit to those registered persons that, but for the Final Rule, would not have to become RFA members. As of June 30, 2015, the following numbers of Commission registered IBs, CPOs, and CTAs (registered in the below categories) were not NFA members (“Non-member Registrants”):⁴³

Registration Category	Non-member Registrants
IB only	21
CPO only	61
CTA only	573
IB & CPO	1
IB & CTA	2
CTA & CPO	41
FCM & CPO	1
TOTAL	700

⁴³ See NFA’s daily directory of CFTC Registrants and Members available at: <http://www.nfa.futures.org/NFA-registration/NFA-directories.HTML>.

Of these Non-member Registrants, however, approximately 138 are pending withdrawal of their Commission registration. The Commission is assuming that these Non-member Registrants will withdraw their registration and, thus, will not be impacted by the Final Rule. In addition, only approximately one percent of the Non-member Registrants registered solely as CTAs reported to the Commission in the most recent reporting cycle that they had directed client accounts.⁴⁴ As such, the Commission believes that many of the Non-member Registrants registered solely as CTAs will be § 4.14(a)(9) Exempted CTAs and, thus, will not be required to comply with the Final Rule.⁴⁵ Accordingly, the Commission estimates that 296⁴⁶ persons registered with the CFTC as a CPO, CTA, or IB will be required to become and remain NFA members as a result of the Final Rule.⁴⁷

Because at this time the Commission cannot reasonably estimate the number of Non-member Registrants that may deregister with the Commission as a result of the Final Rule, the Commission is assuming that no Non-member Registrants will deregister as a result of the Final Rule. The Commission believes that this will lead to an overstatement of the compliance costs relating to the Final Rule.

2. Costs

a. Costs to IBs, CPOs, and CTAs

⁴⁴ The Commission is assuming that all Non-member Registrants registered solely as CTAs have reported to the Commission the amount of assets they have directed, if any.

⁴⁵ For purposes of its analysis, the Commission is assuming that approximately half of the 573 Non-member Registrants registered solely as CTAs (286 Non-member Registrants) will be § 4.14(a)(9) Exempted CTAs and will not be required to comply with the Final Rule, and 20 of these 286 Non-member Registrants will be pending withdrawal of their Commission registration.

⁴⁶ To arrive at the estimate, the 700 figure was reduced by the sum of (i) 138 (the Non-member Registrants whose withdrawal from Commission registration is pending) and (ii) 266 (the Non-member Registrants that the Commission assumes will be § 4.14(a)(9) Exempted CTAs net of those pending withdrawal, as described above).

⁴⁷ For purposes of assessing the costs of this rule, the Commission is assuming that no Non-member Registrant is, absent the Final Rule, required to be an NFA member.

As discussed above, the process for a Non-member Registrant to become an NFA member amounts to checking a box on the CFTC registration form and updating some contact information. Thus, the Commission believes the cost of filing for membership to be non-substantive.⁴⁸

Affected persons are also subject to certain membership fees. NFA imposes initial membership dues and annual membership dues for IBs, CPOs, and CTAs. Currently, such initial membership dues are \$750 for the first year, and the annual dues to maintain membership are \$750 per year thereafter.⁴⁹ Thus, the 296 affected Non-member Registrants, in the aggregate, will incur an initial and ongoing annual registration/membership cost of approximately \$222,000.⁵⁰

The Commission agrees with Lovely that the Final Rule will also impose certain compliance costs on affected Non-member Registrants. However, as noted above, the Commission believes that, given the existing requirements imposed on such registrants, the compliance costs of becoming an NFA member and complying with NFA's rules (including preparing for an audit by NFA) will be partially offset by the costs already incurred by these registrants (i.e., the costs associated with complying with Commission regulations and preparing for examinations by the Commission). In that regard, as discussed above, the Commission disagrees with Lovely's cost estimates and estimates

⁴⁸ See Form 7-R, <http://www.nfa.futures.org/NFA-registration/templates-and-forms/form7-r.HTML>. Applications forms for NFA membership and Associate membership are incorporated in Forms 7-R and 8-R. See NFA Membership and Dues, <http://www.nfa.futures.org/NFA-registration/NFA-membership-and-dues.HTML>.

⁴⁹ See NFA Membership and Dues, <http://www.nfa.futures.org/NFA-registration/NFA-membership-and-dues.HTML>.

⁵⁰ To arrive at the monetary estimate, the 296 figure was multiplied by the \$750.00 per-person annual membership dues.

that an affected registrant may, at most, face additional compliance costs of approximately \$2,950 initially and \$1,476 in subsequent years, equating to an industry total of \$873,200 in the first year and \$436,896 in subsequent years,⁵¹ plus the indirect costs of the periodic audits. The Commission cannot reasonably provide an exact estimate of these costs due to the idiosyncratic nature of the indirect costs incurred.⁵²

b. Other Market Costs

In addition to the direct costs to Commission Registrants, the Commission considered other costs to the markets of the Final Rule. In particular, the Commission considered the impact the Final Rule will have on IBs, CPOs, and CTAs (i) election to not register with the Commission and (ii) optional deregistration, in each case, where such persons are not required to be registered with the Commission. Further, the Commission considered that the requirements of the Final Rule may cause fewer persons to elect to become IBs, CPOs, and CTAs because of the added burden of being an RFA member. The Commission is unable to estimate accurately how many IBs, CPOs, and CTAs will deregister with the Commission or elect not to so register in the future, or how many persons will choose to not become such an intermediary, in each case, as a result of the Final Rule. Further, the Commission believes that if a market participant has chosen not to register with the Commission, the costs incurred by that participant for not registering would be less than the costs that would have been incurred to register.

⁵¹ To arrive at the monetary estimate, the 296 figure was multiplied by the estimated per-person compliance costs.

⁵² The Commission also considered that, in addition to the Non-member Registrants discussed above, the Final Rule will cause future persons registering with the Commission as IBs, CPOs, and CTAs because of their activities in relation to swaps to incur additional costs similar to those described above. The Commission expects that many persons will apply for registration under the Commission's swaps market regime in such capacities, but the Commission is not able to accurately estimate the exact number of new Commission registrants that will do so and, thus, be affected by the Final Rule.

Otherwise, the market participant would likely have chosen to register instead. However, the Commission cannot make a more accurate determination of costs beyond this overestimate without knowing more specifics about a particular market participant.

c. Consideration of the Proposal as an Alternative to the Final Rule

The Commission believes the costs in a. and b. above, respectively, are reduced from those that would have resulted had the Proposal been adopted without modification (the Proposal would have required each registered IB, CPO, and CTA, without exception, to become and remain a member of an RFA), because the Commission has excepted § 4.14(a)(9) Exempted CTAs from the requirements of the Final Rule. This exclusion limits the Commission's ability to oversee these persons through delegation to an RFA; however, the Commission has determined that this reduction in the Commission's oversight abilities is reasonable in light of the burden that the Proposal would otherwise impose on § 4.14(a)(9) Exempted CTAs and the markets. The Commission further notes that, as discussed above, § 4.14(a)(9) Exempted CTAs that are not RFA members are still subject to the Commission's rules and regulations.

3. Benefits

The Final Rule enables the Commission to (i) carry out its obligations pursuant to Section 17 of the CEA to delegate certain oversight responsibility for intermediaries, including IBs, CPOs, and CTAs, to an RFA, and (ii) ensure the fitness of its registrants as described under Section 4p of the CEA. The Commission believes that by requiring RFA membership, the Final Rule results in a more efficient deployment of agency resources which would otherwise have to be used to oversee these registrants who would, without the Final Rule, not be overseen by an RFA. Further, the Commission believes that the

Final Rule enables NFA to apply its experience as a SRO to oversee and ensure the fitness of all registered IBs, CPOs, and CTAs, except § 4.14(a)(9) Exempt CTAs. The markets and the public will benefit from NFA's developed set of rules and oversight capabilities to ensure the integrity of the swaps market and its participants.

4. Section 15(a) Factors

The Commission requested comment on all aspects of the Section 15(a) factors. Except as discussed above, the Commission did not receive any comments relating to costs and benefits of the Final Rule.

Section 15(a) of the CEA requires the Commission to consider the effects of its actions in light of the following five factors:

a. Protection of Market Participants and the Public

The Final Rule will protect the public by ensuring that registered IBs, CPOs, and CTAs, except § 4.14(a)(9) Exempt CTAs, are subject to the same level of comprehensive NFA oversight.

b. Efficiency, Competitiveness, and Financial Integrity of Markets

The Final Rule ensures that all registered IBs, CPOs, and CTAs, except § 4.14(a)(9) Exempt CTAs, are subject to a similar level of oversight and regulatory responsibility. In so doing, the Commission believes the integrity of markets is enhanced. Furthermore, the Commission also believes that the Final Rule will promote public confidence in the integrity of derivatives markets by ensuring consistent and adequate regulation and oversight of registered IBs, CPOs, and CTAs, except § 4.14(a)(9) Exempt CTAs.

c. Price Discovery

The Commission has not identified an impact on price discovery as a result of the Final Rule.

d. Sound Risk Management

The Commission has not identified an impact on the risk management decisions of market participants as a result of the Final Rule.

e. Other Public Interest Considerations

The Commission has not identified an impact on other public interest considerations as a result of the Final Rule.

List of Subjects in 17 CFR Part 170

Authority delegations (Government agencies), Commodity futures, Membership in a Registered Futures Association, Reporting and recordkeeping requirements.

For the reasons stated in the preamble, the Commodity Futures Trading Commission amends 17 CFR part 170 as set forth below:

PART 170 – REGISTERED FUTURES ASSOCIATIONS

1. The authority citation for part 170 is revised to read as follows:

Authority: 7 U.S.C. 6d, 6m, 6p, 6s, 12a, and 21.

2. Add § 170.17 to read as follows:

§ 170.17 Introducing brokers, commodity pool operators, and commodity trading advisors.

Each person registered as an introducing broker, commodity pool operator, or commodity trading advisor must become and remain a member of at least one futures association that is registered under Section 17 of the Act and that provides for the membership therein of introducing brokers, commodity pool operators, or commodity

trading advisors, as the case may be, unless no such futures association is so registered; provided, however that a person registered as a commodity trading advisor shall not be required to become or remain a member of such a futures association, solely in respect of its registration as a commodity trading advisor, if such person is eligible for the exemption from registration as such pursuant to § 4.14(a)(9) of this chapter.

Issued in Washington, DC, on September 9, 2015, by the Commission.

Christopher J. Kirkpatrick,
Secretary of the Commission.

NOTE: The following appendix will not appear in the Code of Federal Regulations.

**Appendix to Membership in a Registered Futures Association – Commission Voting
Summary**

On this matter, Chairman Massad and Commissioners Bowen and Giancarlo voted in the affirmative. No Commissioner voted in the negative.

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